

MAY 24 1996

Before the FEDERAL COMMUNICATIONS COMMISSION Washington, D.C. 20554

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In the Matter of)
)
Policy and Rules Concerning) CC Docket No. 96-61
the Interstate, Interexchange)
Marketplace)
•)
Implementation of Section 254(g))
of the Communications Act of 1934,)
as Amended)

REPLY COMMENTS OF AT&T CORP.

Detariffing, Pricing, Bundling and Related Issues

May 24, 1996

5/24/96

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SUMMARY

AT&T's Reply responds to the comments of other parties on the issues of detariffing, pricing, and the bundling of CPE with interexchange services raised in the Commission's NPRM, and related matters.

The comments confirm AT&T's showing (i) that permissive detariffing for nondominant interexchange carriers is fully authorized under the amended Communications Act and (ii) that permissive detariffing is the best means to accommodate carrier and customer interests in establishing the rates, terms and conditions for interexchange services. In particular, permissive detariffing will preserve significant efficiencies for residential and small business services, and it will ensure that such customers enjoy ready access to the information they demand. At the same time, permissive detariffing will give carriers and large business and government customers the opportunity to use unfiled contracts to establish customized or other individually negotiated service arrangements.

In contrast, the comments also confirm that mandatory detariffing will impose significant costs on carriers and customers, with no countervailing public benefits. In particular, mandatory detariffing could require carriers to incur substantial transaction costs to establish and maintain relationships with millions of customers — costs that would be avoided if carriers were permitted to file tariffs. Further, several commenters confirm that mandatory detariffing is unnecessary to address filed rate doctrine issues, because the rates and terms in unfiled contracts could be enforced under a permissive detariffing rule.

Furthermore, the RBOCs' incessant claims about alleged price coordination in the interexchange market do not support a mandatory detariffing requirement for nondominant carriers, and they are otherwise meritless. Most fundamentally for purposes of this proceeding, the commenters unanimously agree that mandatory detariffing would not

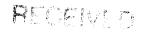
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materially affect the availability of pricing information in the marketplace; thus it could not reduce the already minimal possibilities for tacit collusion. In all events, the NPRM recognizes that there is no proof of any such collusion, and the comments show that the existing market structure makes such collusion highly unlikely and impossible to sustain. The RBOCs' submissions in this proceeding largely repeat the same claims and analyses that have been thoroughly refuted elsewhere by AT&T and other parties, and they provide no basis for contrary findings here.

Therefore, the Commission should adopt a permissive detariffing policy and apply it uniformly to all nondominant interexchange carriers. In particular, the Commission should reject the proposals of TRA and other resellers to subject some nondominant carriers to more burdensome tariffing rules than others. Such rules would impair competition and represent a substantial step backwards in the Commission's efforts to promote competition. The Commission should likewise reject TRA's claim that certain terms and conditions in contract-based tariffs (e.g., deposit requirements) are per se unlawful, because, as the Commission has recognized, there are legitimate business reasons for all of these terms.

Finally, contrary to the claims of some equipment manufacturers, the NPRM correctly concludes that the CPE bundling prohibition should finally be ended. The comments show that the rule has long outlived its usefulness and that it is no longer necessary to foster competition in the CPE market. Both that market and the interexchange market are now highly competitive, and customers demand such package offerings. Thus, continuing the prohibition would affirmatively harm competition and customers.

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Pursuant to Section 1.415 of the Commission's Rules, and its Notice of Proposed Rulemaking, FCC 96-123, released March 25, 1996 ("Notice"), AT&T Corp. ("AT&T") hereby responds to comments of other parties addressed to detariffing, pricing, the bundling of customer premises equipment ("CPE") with interexchange services, and related issues.¹

The comments strongly support the adoption of a permissive detariffing rule for nondominant carriers and the elimination of the rule prohibiting the bundling by such carriers of CPE with interexchange services. Permissive detariffing will provide the flexibility for carriers and customers to order their business relationships in the most efficient manner

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A list of the commenters and the abbreviations used to refer to each is appended as Attachment A.

possible. Mandatory detariffing, in contrast, will produce none of the benefits assumed in the Notice, but will instead impose substantial costs on carriers and customers.

The elimination of the bundling rule is long overdue, consistent with the public interest and mandated under the 1996 Act. Predictably, this proposal is opposed by CPE manufacturers and distributors, but their comments provide no basis to deny to customers the increased choices for integrated services and CPE solutions that they demand. Moreover, the findings of effective competition in the interexchange market also compel the Commission to eliminate the bundling rule as it applies to enhanced services. Here, too, no public interest objective can be served by the continued application of an outdated regulation that restricts competitive providers of services from offering the packages of interexchange and enhanced services that customers require.

I. THE COMMENTS CONFIRM THAT THE COMMISSION SHOULD ADOPT PERMISSIVE, NOT MANDATORY, DETARIFFING.

The comments confirm AT&T's showing that permissive detariffing is authorized and required by application of the forbearance test of Section 10, and that it would promote the maximum feasible deregulation and confer the maximum benefit on consumers. Permissive detariffing would afford carriers and their customers the freedom and flexibility to decide for themselves whether to rely on filed tariffs or individual contracts to define their respective duties, rights and liabilities. Accordingly, permissive detariffing is the most deregulatory alternative available to the Commission.² By contrast, a mandatory detariffing rule would impose unnecessary costs and eliminate the efficiencies that tariffs permit under

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² AT&T, pp. 3-7.

many conditions, without creating any countervailing benefits. Moreover, the mandatory detariffing policy proposed in the Notice likely exceeds the Commission's authority under Section 10 of the 1996 Act.³

Most carriers and many customers filing comments support permissive detariffing and oppose mandatory detariffing. For example, LDDS (p. 5) observes that permissive detariffing will give carriers and customers the "flexibility" to proceed by either contract or tariff, and that tariffs avoid significant transaction costs in many situations. On the other hand, a policy of mandatory detariffing "would needlessly impose enormous costs upon carriers and customers" (LCI, p. 2). Further, many carriers agree with AT&T that mandatory detariffing could entirely preclude carriers from offering service to customers with whom they have no pre-established relationship. 5

Permissive detariffing also addresses the concerns of consumer groups and other customers who do not want to be denied ready access to the comprehensive information that tariffs can provide.⁶ It further addresses the concerns of large business and government

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See AT&T, pp. 7-12; Ameritech, p. 2; CompTel, pp. 19-22; Frontier, p. 5, n.6; Casual Calling Coalition, pp. 12-13.

See also Business Telecom, p. 7; Citizens for a Sound Economy, pp. 4-7; CompTel, pp. 9-10; Frontier, p. 5; MCI, pp. 10-11; Sprint, pp. 10-15.

See, e.g., AT&T, pp. 19-20; Casual Calling Coalition, pp. 2-4; Sprint, pp. 3-4.

See CFA, p. 8; TMISC, pp. 5-6; TRAC, pp. 3-6. None of these claims, however, support a requirement that carriers must file tariffs. As their comments make clear, most carriers consider tariffs to be the most efficient arrangement for doing business with residential and small business customers, and can be expected to file tariffs voluntarily for the services they provide those customers. There is thus no need for a regulatory rule to achieve this result.

customers about the "filed rate" doctrine.⁷ In particular, permissive detariffing will ensure that individual consumers, consumer groups and consultants have access to the pricing information they desire, because carriers will need to make rate information available to customers whether or not they provide services pursuant to tariffs. At the same time, permissive detariffing will provide larger customers the flexibility to do business exclusively under non-tariffed contracts for customized or individually negotiated service arrangements.

Contrary to some commenters' concerns, filed rate doctrine issues provide no basis to make detariffing mandatory instead of permissive. Several commenters agree with AT&T (pp. 20-22) that permissive detariffing would eliminate the statutory basis for invoking the filed rate doctrine with respect to customers who are parties to unfiled contracts. After the Commission exercises its statutory authority to permit carriers to provide service at unfiled rates, carriers and their customers may lawfully choose to do business under unfiled contracts. In such cases, the carrier could not claim that a tariffed rate is the "lawful" rate for the services provided under the agreement, and it thus would not be able to unilaterally alter the agreement by filing an inconsistent tariff. Permissive detariffing, therefore, fully addresses the concerns of Ad Hoc, API and the other large customers which -- erroneously -- perceive mandatory detariffing as the only solution to the alleged "problems" associated with the filed rate doctrine.

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⁷ Ad Hoc, pp. 3-11; API, pp. 6-9; Networks, p. 4.

Frontier, p. 5 n.6 ("the filed rate doctrine would, by definition, not apply to contract-based arrangements that carriers choose not to file in their tariffs"). See also LDDS, pp. 12-13.

There is also no need for the Commission to consider any of the alternative filing approaches urged by some commenters, such as permitting tariffs that contain terms and conditions but exclude rates, or requiring carriers to post rates electronically in lieu of tariffs. Allowing carriers to tariff only terms and conditions would create the same inefficiencies and dislocations that would be caused by mandatory detariffing. GSA's proposal that carriers should be required to post information "correspond[ing] to tariffs" on electronic bulletin boards essentially would require continuation of the present tariff filing regime, albeit in a different medium, and is based on the mistaken notion that mandatory detariffing is necessary to avoid the consequences of the filed rate doctrine.

Permissive detariffing also eliminates any basis for Ad Hoc's proposal (p. 13) that carriers and customers should be allowed to "re-evaluate" their existing contracts "in light of tariff withdrawals." Both carriers and customers would continue to be bound by the terms of the existing tariff -- exactly the deal the customer had negotiated -- unless both subsequently agree to be bound by a superseding contract. ¹² Indeed, Ad Hoc itself appears to recognize that this concern arises only if "tariff withdrawal" is required by a mandatory detariffing rule.

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⁹ <u>See</u>, <u>e.g.</u>, Frontier, p. 6; LCI, pp. 4-5.

¹⁰ See, e.g., GSA, pp. 11-12; TRAC, pp. 6-7.

¹¹ Ironically, GSA's proposal that the Commission adopt mandatory detariffing but require carriers to provide the same information electronically would appear to have no effect on the filed rate doctrine, which is based not on the manner or place of filing, but on the imposition of a filing requirement.

This would not change the respective rights or reasonable expectations of either party under a customized agreement. Where the parties had anticipated and agreed that the carrier would be free to make tariff changes during the term of a contract tariff (for example, a negotiated discount off tariff rates instead of a fixed rate arrangement), the parties' expectations could be met by the carrier's retention of either "tariff" or "list" prices, with the discount continuing to apply as it had before.

In all events, a Commission decision to adopt mandatory detariffing would have no effect on the commitments both parties had previously made to each other, as the Commission has recognized in analogous circumstances. Ad Hoc's concerns would be better addressed by a transitional rule that requires existing contract tariffs and similar arrangements to remain in effect as written (including the terms of underlying agreements as they may change from time to time), unless and until both parties agree to new terms. There is simply no basis for allowing a party to abandon the terms of a deal to which it voluntarily agreed in a competitive market, particularly under the guise of a new rule that is adopted (unnecessarily, in AT&T's view) to prevent that very result under a different rule (i.e., the filed rate doctrine).

II. THE RBOCS' UNFOUNDED CLAIMS OF TACIT COLLUSION IN THE INTEREXCHANGE MARKET DO NOT SUPPORT A MANDATORY DETARIFFING RULE AND SHOULD BE REJECTED -- AGAIN.

Although BellSouth and some other RBOCs repeat their incessant and baseless claims of tacit collusion in the interexchange market, the comments show that these allegations do not support -- and are irrelevant to -- the Commission's mandatory detariffing proposal.¹⁴ The Notice (¶81) recognizes that there is no persuasive proof of any such collusion, and the

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When confronted with similar arguments in response to CPE detariffing, the Commission found that detariffing alone has no impact on the rights and responsibilities of parties to an agreement that was entered into under a tariff regime. See, e.g., Procedures for Implementing Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), 100 F.C.C.2d 1298 (1985). See also Central Controls Company, Inc. v. AT&T Information Systems, Inc., 746 S.W.2d 150 (Mo. App. 1988) (similar conclusion by state court).

Indeed, BellSouth (pp. 22-25) admits that its comments are principally intended to justify RBOC entry into in-region interLATA services, not to support the Commission's mandatory detariffing proposal.

comments show that numerous structural conditions in the interexchange market (including, among other things, the large amount of excess capacity and the unequal market shares of the largest competitors) make collusion among IXCs highly unlikely and virtually impossible to sustain.¹⁵

Even more fundamentally, however, mandatory detariffing would have no impact on IXCs' theoretical ability to collude, because such carriers will still have to publicize rates for their services -- particularly for consumers in the broader consumer and small business market segments where collusion has been alleged -- whether or not they file tariffs. Moreover, Frontier (p. 6) notes that permissive detariffing further minimizes even the theoretical opportunities for collusion, by creating market uncertainty and encouraging "cheating." Thus, as NYNEX (p. 4) recognizes, "the issue for this proceeding is not whether price collusion has occurred in this market, but, rather, what measures the Commission should take to further the public interest."

Accordingly, there is no need to rebut the RBOC oligopoly claims in detail here, especially when they have recently been completely refuted elsewhere. Nevertheless, AT&T reiterates the following points in reply:

(footnote continued on following page)

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¹⁵ See AT&T, pp. 22-24; CFA, p. 7; CompTel, pp. 11-14.

See, e.g., AT&T, pp. 13-15; Ameritech, p. 8; CFA, p. 7; CompTel, pp. 10-14; LDDS, pp. 11-12; Ohio, p. 5 ("requiring publicly filed tariffs gives no more information than would be available in a free market").

See Affidavit of B. Douglas Bernheim and Robert D. Willig, Attachment G to AT&T ex parte letter from G. Salemme to K. Wallman, dated April 24, 1995, CC Docket No. 79-252 ("Bernheim & Willig"); D. Kasserman and J. Mayo, "Is AT&T 'Dominant?' An Assessment of the Evidence," attachment to June 12, 1995 ex parte letter from C. Ward to W. Caton, CC Docket No. 79-252 ("Kasserman & Mayo"); J. Haring, J. Rolfs and H. Shooshan III, "Disabilities of Continued Asymmetric Regulation of AT&T," Attachment 1 to AT&T's

- 1. The Commission has previously found correctly that "several factors" make tacit collusion in the interexchange market highly unlikely. The large number of competing providers, the great amount of excess capacity, the complexity of pricing and the unequal market shares of the current providers not only make any such collusion highly unlikely but also impossible to sustain. 19
- 2. The Commission has found that there are low barriers to entry in the interexchange market, and that such low barriers, together with substantial excess capacity, give carriers "great incentive" to "keep[] their prices low."²⁰
- 3. The RBOCs' collusion claims are based upon the manner in which the top three carriers have changed their basic rates. The Commission has recognized that such changes can all be explained by procompetitive and benign market forces, including normal cost-based pricing activities that follow the removal of regulatory pricing constraints that have

(footnote continued from previous page)

June 30, 1995 Reply Comments in CC Docket No. 79-252. ("Haring et al."), which are incorporated herein by reference. See also three additional affidavits AT&T submitted to the Justice Department in response to RBOC experts' claims (including affidavits of Professor MacAvoy) that attempted to persuade the Department to recommend termination of the interexchange restriction in the MFJ on the ground that the interexchange market was not sufficiently competitive: Affidavit of R. Glenn Hubbard and William H. Lehr, dated December 5, 1994 (Attachment B hereto); Reply Affidavit of R. Glenn Hubbard and William H. Lehr, dated August 17, 1995 (Attachment C); Reply Affidavit of B. Douglas Bernheim and Robert D. Willig, dated August 27, 1995 (Attachment D).

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See, Revisions to Price Cap Rules for AT&T Corp., Report and Order, 10 FCC Rcd. 3009, 3018 (1995) ("AT&T Price Cap Order").

See Bernheim & Willig, pp. 153-56; Attachment B, pp. 30-31; Attachment D,
 pp. 109-112; Kasserman & Mayo, pp. 40-48.

AT&T Price Cap Order, 10 FCC Rcd. at 3018; see also Bernheim & Willig, p. 131 (excess capacity tend[s] to promote intense rivalry); Kaserman & Mayo, pp. 42-43.

kept rates below cost.²¹ Thus, the true measure of competition is in the middle and high volume segments.²² BellSouth does not -- and cannot -- argue that prices in such segments, which include the majority of residential calls that are now covered by discount plans, demonstrate any coordinated pricing pattern.²³

4. Professor MacAvoy's attempts to use price-cost margins to demonstrate above-cost prices are biased because they inflate the "price" component and also leave out many costs.²⁴ More fundamentally, AT&T's expert economists have shown that this type of analysis is misconceived, because such margins cannot accurately measure competition.²⁵

III. NONDOMINANT CARRIERS SHOULD NOT BE SUBJECT TO DIFFERENT REGULATORY RULES OR TO BLANKET LIMITATIONS ON SPECIFIC TARIFF TERMS AND CONDITIONS.

The Commission should reject TRA's proposals that different IXCs should be subject to different tariff filing requirements, and that the Commission should declare certain

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See Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, FCC 95-427, released October 23, 1995, petitions for recon. pending ("AT&T Reclassification Order"), ¶¶76, 82. See also Bernheim & Willig, pp. 136-140, 150-52; Attachment D, pp. 118-22, 135-37; Attachment C, pp. 19-20; Kasserman & Mayo, pp. 50-51.

Bernheim & Willig, pp. 140-42; Attachment B, pp. 7-9; Attachment D, pp. 122-28.

BellSouth also cannot deny that AT&T's average revenue per minute -- the best measure of AT&T's prices -- has declined each year since divestiture (see "Trends in Telephone Service," Industry Analysis Division, Common Carrier Bureau, May 1996, p. 12). Moreover, its assertion that AT&T's prices have sometimes fallen less than access reductions has been repeatedly rejected (see, e.g., AT&T Reclassification Order, ¶79; Haring, et al., p. 26 and Table 1; Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd. 8961, 8987 (1995) ("We also conclude that the IXCs have passed the savings they have received from lower interstate exchange access charges to end-users").

See Attachment B, pp. 16-29; Attachment C, pp. 3-8.

See Bernheim & Willig, pp. 161-62; Attachment D, pp. 140-150.

tariff provisions per se unlawful. The Commission has found that AT&T and all non-LEC affiliated IXCs are nondominant, because they lack market power and cannot adversely affect prices in the market. This finding applies equally to all nondominant carriers, regardless of their size, and it would be arbitrary to establish different tariffing rules for different nondominant carriers, either with respect to rate specificity or filing periods. The Commission has consistently and correctly rejected similar proposals by TRA, ACTA and other resellers, and TRA provides no basis for a different result here. Indeed, the re-imposition of a 14-day notice period for tariff changes and special tariff filing rules for selected nondominant carriers would be fundamentally inconsistent with the Commission's procompetitive, deregulatory policies.²⁶

TRA's (p. 22) request that the Commission should prohibit certain carrier practices which allegedly "render[] a service offering either unavailable to resale carriers or unresellable" should likewise be rejected -- again.²⁷ The appropriate inquiry under

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On the other hand, AT&T would not oppose a limited form of TRA's proposal (p. 33) that any non-consenting customer should have an opportunity to terminate its subscription to a contract-based tariff without liability if a carrier changes the tariff, provided that such a rule applies equally to all carriers. Contrary to TRA's proposal, this opportunity should apply only to those changes that have a material adverse effect on non-consenting customers. Thus, customers could reasonably be given an opportunity to terminate a prior service commitment without liability under a tariff's original terms if (i) a carrier changes its contract-based tariff without the customer's consent and (ii) the carrier does not "grandfather" the non-consenting customer (so that the change does not apply to the customer) and (iii) the change has a material adverse impact on the rates, terms or conditions of the customer's service.

See AT&T Communications Revisions to Tariff F.C.C. No. 12, 6 FCC Rcd. 7039, 7055 (1991) (noting also that parties should not "confuse a generally available tariff offering with a generally useful tariff offering" (id. at 7051)). Thus, an offering is not unlawful simply because a customer that was not a party to the original negotiation may find it difficult, economically infeasible, or otherwise undesirable to use the offering for its own purposes.

Sections 201 and 202(a) of the Act, which prohibit only "unreasonable" practices or "unreasonable" discrimination, is whether a rate or term has a legitimate business purpose. Indeed, even the <u>PSE</u> case quoted by TRA (p. 24) considered whether the requirements at issue "had no valid business purpose . . . as applied to resale or non-resale customers." ²⁸

The specific practices about which TRA (pp. 23-24) complains include: (1) a limit on the number of locations where a service may be used; (2) a cap on discounts at a specified revenue level; (3) limits on the percentage of switched access services available in an offering; (4) location identification requirements; and (5) deposit requirements. None of these conditions prevents resale; to the contrary, offerings with one or more of these provisions have been and continue to be resold by various TRA members. Moreover, each of these practices has valid, cost-based business purposes. For example, a limit on the number of locations controls the carrier's total cost for installation and billing and — in conjunction with revenue commitments — ensures that the average revenue per location usage level will exceed a minimum amount.²⁹ A discount cap encourages a customer whose traffic has grown significantly above the amount on which the commitment level was based to re-negotiate its arrangements with the carrier, enabling the carrier to seek higher commitment levels that are more in line with the customer's current needs. Requiring a balance between a customer's switched and dedicated access usage reflects the fact that carriers have higher costs to serve

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Public Services Enterprises of Pennsylvania, Inc. v. AT&T Corp., 10 FCC Rcd. 8390 (1995) ("PSE").

The Commission expressly recognizes that in some circumstances "it would be reasonable to impose limits on the number of locations served by an offering, <u>e.g.</u>, if the cost characteristics of an existing option were premised on service to a limited number of locations." <u>PSE</u>, 10 FCC Rcd. at 8398.

locations that use switched access. Thus, the type of access a customer uses directly affects the carrier's costs and impacts the overall prices it can afford to offer.

Location information is important for two reasons. First, it is impossible to provide service, or know the actual costs of such service, without knowing the location(s) where service will actually be provided. Second, especially in the context of Tariff 12-type services, it is necessary to have some location information to determine whether a customer is "similarly situated" to the initial customer with whom the service was negotiated (with respect to such factors as costs to serve and competitive circumstances) and thus eligible (or ineligible) for the service. Finally, the propriety of deposits to protect carriers against risks of non-payment is well-established. 31

IV. THE COMMENTS CONFIRM THAT THE PROHIBITION AGAINST BUNDLING OF INTEREXCHANGE SERVICES WITH CUSTOMER PREMISES EQUIPMENT SHOULD BE ELIMINATED.

There is broad support for the Commission's proposal to eliminate the current rule prohibiting the bundling of CPE and interexchange services provided by nondominant carriers.³² Commenters endorsing this long overdue change include not only interexchange³³

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The Commission has confirmed that a carrier may refuse to provide actual service to a customer if the customer does not provide design detail sufficient to show that it is similarly situated with other subscribers to a service. Id., 10 FCC Rcd at 8397.

Id. at 8398 (deposits are an appropriate "protective financial tariff provision" carriers may use to protect themselves against financial risk).

³² See Notice, ¶84-90. See also 47 C.F.R. § 64.702(e).

³³ Sprint, pp. 26-29; Excel, pp. 5-6; GCI, pp. 5-6; LDDS, pp. 17-19; MCI, p. 24.

and local exchange carriers,³⁴ but also telecommunications customers,³⁵ telecommunications resellers,³⁶ state public utilities commissions,³⁷ and an equipment manufacturer.³⁸

These commenters overwhelmingly confirm that the rule has outlived its usefulness. It is a classic vestige of monopoly utility regulation, originally intended to protect consumers and emerging CPE competitors from potential abuse of market power.³⁹ Today. however, it is widely viewed as a hindrance to the ability of carriers to develop innovative offerings to meet the demands of customers for end-to-end solutions, and has thus become affirmatively harmful to consumers and to competition.⁴⁰

Although the local exchange carrier ("LEC") commenters do not oppose elimination of the bundling rule for nondominant interexchange carriers, they predictably complain that eliminating the rule as proposed would disadvantage them, particularly when they compete with interexchange carriers classified as nondominant. Accordingly, they urge

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Bell Atlantic, pp. 5-7; Frontier, pp. 7-8; GTE, pp. 10-11; NYNEX, pp. 6-7; Pacific Telesis, pp. 11-12; Rural Telephone Coalition, p. 15; SBC, pp. 6-8; USTA, pp. 3-4; U S WEST, pp. 7-9.

³⁵ Ad Hoc, pp. 12-13; API, pp. 11-17; Ohio Consumers' Counsel, pp. 8-9.

³⁶ TRA, pp. 40-42.

Florida PSC, pp. 16-19; Louisiana PSC, pp. 8-11.

³⁸ Compaq, pp. 3-5.

³⁹ See Notice, ¶84.

The Commission has a mandate, under Section 10 of the 1996 Telecommunications Act, to determine whether regulations are no longer "in the public interest as the result of meaningful economic competition between providers of such service" and, if such competition exists, to repeal such regulations. Nowhere is that mandate more compelling than here, where it is undisputed that effective competition exists in both the interexchange and CPE markets, and where the only groups supporting retention of the bundling rule are CPE manufacturers and distributors, invariably seeking shelter from competition.

the Commission to extend its proposal to <u>all</u> carriers. Despite their claims, however, the dispositive fact is that the LECs are monopoly providers of local exchange and exchange access services. The LECs' monopoly also presumptively confers market power to the extent they enter the interexchange business for so long as interexchange carriers remain dependent on LEC bottleneck services. For this reason, LECs present starkly different competitive circumstances than do nondominant interexchange carriers, and there is thus no need or basis to consider them in the context of this proceeding.

A. The Comments Confirm That The Bundling Prohibition Is No Longer Necessary To Foster Competition In The CPE Marketplace.

The comments of customers such as API confirm that customers demand and benefit from packages of interexchange service and CPE, which provide them with wider choice, greater efficiencies, and value. ⁴² The bundling rule, in contrast, acts as a constraint on the customer's ability to obtain an innovative or attractive end-to-end communications solution; acts as a brake on the development and implementation of advanced communications technology, to the detriment of users, service providers, and the economy as a whole; and increases the communications costs to large customers. ⁴³ In addition, the bundling rule

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⁴¹ Bell Atlantic, p. 6; GTE, p. 11; NYNEX, pp. 6-7; SBC, pp. 6-8.

The Commission has, on the record in other proceedings, further evidence of customer demand for integrated offers. See, e.g., Reply Comments of United Technologies (filed February 10, 1995) ("the option should . . . exist to purchase [transport and equipment] as a bundled service") in Petition for a Declaratory Ruling That AT&T's InterSpan Frame Relay Service Is a Basic Service That Must Be Offered Under Tariff.

API, Statement of Raymond E. Cline, Jr., p. 3.

prevents customers from "reduc[ing] their transaction costs by requesting that [the service provider] provide both the communications services and equipment in a bundled package."

The basic concern underlying adoption of the rule in 1980 was that the vitality and extent of competition for interexchange services and CPE was uncertain. However, it has long been established in a series of Commission decisions that the markets for both interexchange services and CPE are workably competitive, and that no carrier or CPE vendor has "market power." On this basis, the Commission now correctly concludes (Notice, \$\quad 88\$) that "it is unlikely that non-dominant interexchange carriers can engage in the type of anticompetitive conduct that led the Commission to prohibit the bundling of CPE with the provision . . . of interstate, interexchange services."

The fact that only CPE manufacturers and distributors have urged retention of the rule itself underscores that the rule is an example of unnecessary regulation.⁴⁷ None of their arguments justifies further interference with the freely competitive marketplace. Where,

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Sprint, p. 28. See also Louisiana PSC, p. 10; GCI, p. 6.

See Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Final Decision, 77 F.C.C.2d 384, 438-447 (1980) ("Final Decision"), modified on recon., 84 F.C.C.2d 50 (1980), further modified on recon., 88 F.C.C.2d 512 (1981), aff'd sub nom. Computer and Communications Indus. Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1984).

See, e.g., Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd. 8961, 9122 (1995) ("competition today is a fact in both the customer premises equipment and the long-distance market"); Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), Memorandum Opinion and Order, 8 FCC Rcd. 3891 (1993) ("[t]he CPE market has been very competitive for a number of years and there are many suppliers available to provide CPE") (citations omitted).

⁴⁷ See Alabama PSC, pp. 9-10.

as here, market forces provide adequate protection to consumers, regulation is no longer needed as "a substitute for deficiencies in the marketplace," and the Commission has a strong mandate to refrain from imposing regulatory constraints. 49

IDCMA argues (pp. 32-39) that elimination of the unbundling rule will allow interexchange carriers to engage in anticompetitive conduct by "dictat[ing] their customer's CPE choice" through the exercise of some form of market power. The short answer is that no interexchange carrier can dictate any prices or terms to customers because, lacking market power, they will simply lose business to competing carriers that will meet those customers' specific needs. Moreover, it is the customers themselves who demand bundled offers from their service providers. Denying customers the additional option of obtaining their services and equipment on an integrated basis from their interexchange carrier serves only to restrict customer choice -- plainly not a public interest goal.

IDCMA also contends (pp. 34-36) that the Supreme Court's <u>Kodak</u> decision⁵¹ compels the Commission to conclude that interexchange carriers may nonetheless have the ability to "force" customers to purchase carrier-provided CPE notwithstanding the

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Final Decision, 77 F.C.C.2d at 441.

See p. 13, n.40, supra; see also Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Memorandum Opinion and Order, 84 F.C.C.2d 50, 96 (1980) (the Commission should only "apply regulatory mechanisms where warranted").

See, e.g., API, Statement of Raymond E. Cline, Jr. ("the bundling prohibition acts as a constraint on a customer's ability to devise an innovative end-to-end communications solution that satisfies that customer's unique needs. This artificial constraint precludes customers from designing an optimum communications network in conjunction with its vendor(s) and/or service provider(s)").

⁵¹ Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992).

Commission's findings as to their lack of market power. According to IDCMA, customers who purchase packages will not "separately consider the costs and benefits of CPE," and will later find themselves "locked in" to long-term services arrangements which will somehow "force" the customers to meet their "future" equipment needs with "additional carrier-provided CPE." This argument misstates Kodak. Although the Court did not find that Kodak had market power in the original equipment market for photocopiers, it did find that Kodak had market power in the replacement parts aftermarket, which Kodak abused through its tying of repair services. ⁵² In the case of interexchange communication services -- the "tying market" according to IDCMA -- IDCMA concedes that no carrier holds market power; thus, contrary to IDCMA's claim, there can be no anticompetitive "forcing," either by individual interexchange carriers, or by each interexchange carrier selectively "teaming" with certain CPE vendors. ⁵³

Finally, many commenters contend that it is necessary that the Commission require carriers to make all services included in a bundled offer also separately available on an unbundled basis.⁵⁴ Such regulation is unnecessary, however, where competition will drive the types of services that will be made available in the marketplace. If consumers demand that

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⁵² Id. at 464-480.

The additional claims that "teaming up" of service providers and CPE manufacturers would deprive consumers of the benefit of a truly independent manufacturing sector and thus reduce competition among CPE manufacturers and distributors are speculative at best. See IDCMA, pp. 16-20; ITAA, p. 4.

See, e.g., ACTA, p. 18; Ad Hoc, p. 13; GCI, pp. 5-6; GTE, p. 11; LDDS, p. 19; Louisiana PSC, pp. 10-11; Ohio Consumers' Counsel, pp. 8-9; Pennsylvania PUC, p. 12; USTA, pp. 3-4.

services and CPE remain available on an unbundled basis, carriers and CPE vendors that fail to provide unbundled services will simply lose business.⁵⁵

B. The Additional Arguments Of Several Commenters Fail To Support Retention Of The Rule.

None of the other purported evils that, according to certain CPE manufacturers and vendors, elimination of the bundling restriction will unleash, raises any legitimate concern which would warrant the Commission to retreat from its tentative conclusion that elimination of the rule is procompetitive and consistent with the public interest.

IDCMA contends (pp. 13-16) that CPE bundling violates Section 202 of the Communications Act, because an interexchange carrier may choose to offer its transmission service only in conjunction with CPE, which would constitute an unlawful "discrimination." This argument is entirely misplaced. First, no discrimination issue arises under Section 202 so long as an offer, including a bundled offer, is made available to all similarly situated customers. Moreover, removal of the bundling rule does not affect the application of Section 202 to common carrier offerings; to the extent that carriers offer both bundled and unbundled service offerings, they are still bound under Section 202 to ensure that any price differentials among communication services are reasonable. ⁵⁶

(footnote continued on following page)

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See Compaq, pp. 4-5 ("Compaq sees no role for mandatory unbundling of service in [competitive] markets. In competitive markets where bundling is to be permitted, market forces should be sufficient to deter unwanted behavior that might harm the public interest. Any further regulation of those markets would be unnecessary and contrary to the principles enumerated in the 1996 Act").

⁵⁶ IDCMA further claims (p. 15) that under Section 202 a carrier "may not price terminal equipment with the intent of providing extra benefits or inducements for regulated service customers," citing <u>ITT World Communications, Inc. v. TRT Telecommunications Corp.</u>, ENF-82-4, 51 Rad. Reg. (P&F) 1386, 1390-91 (Com. Car. Bur. 1982)). The <u>ITT</u> case lends no support for IDCMA's Section 202 argument. First, the ITT case, which required

would be inconsistent with Section 304 of the 1996 Act, which prohibits multichannel video programming system operators from requiring a customer to purchase or lease equipment as a condition of receiving service. There is no inconsistency between the policies underlying the 1996 Act and the Commission's proposal here. Unlike the interexchange and CPE markets, each of which the Commission has found to be competitive, the video services market is today characterized by monopoly providers serving exclusive operating territories. As was asserted to be the case when the Commission adopted the bundling rule for common carrier services and CPE, the state of competition in the video services market could justify continued regulation of the types of offerings to be made available by video programmers.⁵⁷ Where, as here, the markets for both interexchange services and CPE are fully competitive, the rationale for retaining the bundling restriction does not exist.⁵⁸

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⁽footnote continued from previous page)

separation between the provision of record carrier services and CPE, was based on the Record Carrier Competition Act of 1981 ("RCCA") (P.L. 97-130, 95 Stat. 1687) and <u>not</u> on Section 202. Furthermore, in the instant case, the Commission is proposing to <u>eliminate</u> the rule that, like the RCCA, currently prohibits such bundling activities. By eliminating the rule itself here, the Commission will have addressed and decided (to the contrary) the legal basis for the decision in ITT.

See <u>Final Decision</u>, 77 F.C.C.2d at 443, n.52 ("In regulated markets characterized by dominant firms, there may be an incentive, however, to use bundling as an anti-competitive marketing strategy, <u>e.g.</u>, to cross-subsidize competitive by monopoly services. . . . Restricting bundling practices in such markets reduces these impediments to improve consumer welfare").

Moreover, the 1996 Act's sunset provision, which requires termination of the bundling prohibition on multiple video programmers, adopts the same competition and public interest standards that the Commission has applied here. Thus, contrary to the contention of IDCMA (p. 21) that the Commission's "mechanical reliance" on its prior findings of fact "stands in stark contrast to Congress' direction" in the context of video programmers, the Commission's procedures in this notice and comment rulemaking proceeding (including its reliance on recent findings in prior Commission proceedings) are entirely consistent with those standards.

IDCMA's further argument (p. 23) that lifting the bundling prohibition will lead to re-regulation of CPE is equally specious. The provision of CPE in conjunction with the offering of telecommunications services falls far short of "regulating CPE." Although the funding of a CPE offer by the common carrier would constitute a "practice affecting charges" and thus require reference in a carrier's tariff, the mere referencing of CPE in a carrier's tariff does not itself constitute the "regulation" of such CPE. No one -- including the Commission -- has suggested that the Commission would impose Title II regulation over the prices, terms and conditions of CPE merely by virtue of the fact that such CPE is referenced in a carrier's tariff as part of a combined offer. Moreover, in light of the Commission's Computer Inquiry decisions, in which the Commission held that CPE is not a "communication service," the Commission would in all events be precluded from exercising Title II regulation in that market. ⁵⁹

Nor will the removal of the bundling restriction make compliance with the network disclosure and Part 68 rules more difficult, as certain commenters contend. Indeed, the removal of the bundling restriction will have <u>no</u> effect on those rules. The network disclosure rules impose requirements on carriers to disclose information relating to network design to all interested parties on the same terms and conditions, insofar as such information affects either intercarrier interconnection or the manner in which interconnected CPE operates. This disclosure requirement exists whether or not the CPE that will interconnect

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See Final Decision, 77 F.C.C.2d at 452.

⁶⁰ See ITAA, pp. 5-6; IDCMA, pp. 26-27.

Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Memorandum Opinion and Order, 84 F.C.C.2d 50, 82-83 (1980).

with the carrier's network is sold as part of a bundle, is offered separately by the carrier, or is offered directly to customers by a CPE manufacturer or distributor. Moreover, the offering of CPE by carriers will not alter the definition of "CPE," or otherwise affect an end user's right to interconnect with -- or a CPE manufacturer's ability to build to -- a carrier's network under Part 68. IDCMA's suggestion (p. 25) that carrier-provided CPE would change the network boundary is thus entirely fallacious.

IDCMA's claims (pp. 28-30) that adoption of the Commission's proposal to allow CPE bundling by nondominant interexchange carriers would breach U.S. international trade agreements and obstruct U.S. trade policy are also unfounded. As noted above, the Commission is <u>not</u> proposing to allow carriers to restrict the interconnection of competitively-provided CPE; thus CPE bundling will have no effect on the ability of services suppliers from other countries to attach the equipment of their choice to U.S. telecommunications networks. Consequently, the Commission's proposal would not breach U.S. obligations under the General Agreement on Trade in Services ("GATS") and the North American Free Trade Agreement to provide such interconnection rights.

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IDCMA's concern (pp. 30-32) that foreign countries would not accept a market power threshold for regulation, and would therefore be less likely to open their equipment markets to U.S. suppliers, is belied by thirty countries' acceptance thus far in the GATS Negotiations on Basic Telecommunications ("NGBT") of regulatory principles incorporating a similar threshold. See "New Telecom Deadline Prompts Hopes For Bigger Deal Next Year," Inside U.S. Trade, May 3, 1996, at 5, 6. Under those principles, carriers classified as "major suppliers" on the basis of their market power would be subject to regulatory measures to prevent anticompetitive practices and to ensure the provision of interconnection arrangements, while other carriers would be subject to no such requirements. See Final Draft of WTO Telecom Regulatory Principles, Inside U.S. Trade, April 26, 1996, at 10 ("A major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the market for basic telecommunications services as a result of: (a) control over essential facilities; or (b) use of its position in the market."); id. at 10-11.